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CWILSON

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District Counsel, Jacksonville SE:JAX

Acting Director, Tax Litigation Division CC:TL

Request for Technical Advice: At-Risk Determinations in TEFRA
Partnership Proceedings

This memorandum responds to your undated request for technical advice on the above-referenced matter which you forwarded on behalf of the Quality Review Staff.

ISSUE

Whether the "at-risk" determination for purposes of the allowable loss and/or investment tax credit of either a partner in a TEFRA partnership or a shareholder in a TEFRA subchapter S corporation should be considered a "partnership item" or a "nonpartnership item."

CONCLUSION

A partner's amount at-risk under section 465 of the Internal Revenue Code is a partnership item under section 6231 to the extent that amount is determinable at the partnership level. To the extent that partner-level determinations are required, the partner's amount at-risk is an affected item.

FACTS

Revenue agents frequently encounter cases involving taxpayers who are partners in partnerships governed by the special audit provisions of section 6221-6233 or who are shareholders in subchapter S corporations governed by the special audit provisions of sections 6241-6245. In many of those cases the taxpayer is claiming deductions and credits that are subject to the limitations of section 465 and section 46(c)(8). In some of those cases the related partnership or subchapter S corporation is under examination in another district and in some cases it is not.

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ANALYSIS

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and the Subchapter S Revision Act of 1982 enacted significant procedural changes with respect to tax controversies involving partnerships and subchapter S corporations respectively. See I.R.C. §§ 6221-6245. Under the law as it existed prior to 1982, all adjustments to partnership items or subchapter S items were determined and, where necessary, litigated at the partner or shareholder level respectively. For entities qualifying for TEFRA or Subchapter S Revision Act treatment, the procedures provide for a unified partnership or S corporation level proceeding.

Section 6221 provides that the tax treatment of any partnership item shall be determined at the partnership level. Section 6241 provides that the taxpayer treatment of any subchapter S item shall be determined at the corporation level.

Section 6231(a)(3) defines a partnership item as any item required to be taken into account for the partnership's taxable year under any provision of Subtitle A to the extent regulations prescribed by the Secretary provide that for purposes of the Subtitle such item is more appropriately determined at the partnership level than at the partner level. Section 6245 provides a parallel definition of subchapter S item. In addition, section 6244 provides that the provisions relating to partnership items are (except to the extent modified or made inapplicable in regulations) extended to and made applicable to subchapter S items.

Your request concerns whether a partner's amount at risk under section 465 is a partnership item for purposes of section 6231(a)(3). Section 465 generally limits an individual's taxable year losses for certain activities to the amount the individual is at risk for at the close of the taxable year. Section 46(c)(8) provides a similar limitation in the case of the investment tax credit.

Treas. Reg. § 301.6231(a)(3)-1 addresses the extent to which the determination of a partner's amount at risk is considered a partnership item. It provides, that "amounts determinable at the partnership level, with respect to partnership assets, investments, transactions and operations necessary to enable the partnership or the partner to determine ... [a]mounts at risk in any activity to which section 465 applies", are partnership items. (Emphasis added).^{1/}

^{1/} We note that your request for technical advice cites Prop. Treas. Reg. § 301.6231(a)(3)-1(a)(1)(vi). That regulation has been issued in final form. T.D. 8082, 1986-1.

footnote ^{1/} continued on page 3

Even if a partner's amount at risk is not a partnership item, it may be an "affected item." Any item is an "affected item" to the extent it is affected by a partnership item. I.R.C. § 6231(a)(5). The period of limitation for assessing tax attributable to an affected item is the same as for a partnership item. I.R.C. § 6229.

According to Temp. Treas. Reg. § 301.6231(a)(5)-1T(c), an affected item includes items unrelated to the items reflected on the partnership return. Application of the at risk limitation under section 465 to a partner with respect to a loss flowing from a partnership is an affected item to the extent it is not a partnership item.

A determination of whether a partner's amount at risk is a partnership item depends upon whether the determination of the amount at risk is made at the partner-level or the partnership-level. The determination of a partner's amount at risk generally involves several determinations, some of which can be made at the partnership-level and others that can only be made at the partner-level. To the extent that such determinations can be made at the partnership-level, a partner's basis and amount at risk are partnership items; to the extent that partner-level determinations are required, they are affected items. Treas. Reg. § 301.6231(a)(3)-1(a)(1)(vi)(c) and Temp. Treas. Reg. § 301.6231(a)(5)-1T(c).

For example, a partner's amount at risk would require a partnership-level determination where a partnership engaged in an activity subject to section 465 had borrowed an amount for use in that activity. The partner's share of the partnership liability for purposes of section 465 would require a partnership-level determination. As a result, that portion of the partner's amount at-risk would be a partnership item under section 6231.

footnote 1/ continued

1/ C.B. 359. In response to comments similar to those raised in your memorandum, the final regulation was modified. Those comments pointed out that personal arrangements between a partner and a third party may be relevant in determining to what extent a partner is "at-risk" in a partnership activity to which section 465 applies. The commentators expressed concern that proposed section 301.6231(a)(3)-1(a)(1)(vi)(c) treated these personal arrangements as "partnership items." As a result, when the final regulations were issued, the phrase "determinable at the partnership level" was added to make clear that such personal arrangements are not partnership items. T.D. 8082.

Where a partner borrowed money to purchase a partnership interest in a partnership engaged in an activity subject to section 465, the character and amount of the borrowing for purposes of section 465 would require a partner-level determination. The partner's amount at risk attributable to that borrowing would be an affected item. Temp. Treas. Reg. § 301.6231(a)(6)-1T(a).

If a change in a partner's tax liability cannot be made without one or more partner-level determinations, that portion of the change of tax liability attributable to the partner-level determination shall be made under the normal non-partnership audit provisions (relating to deficiency procedures). Thus, changes in a partner's tax liability with respect to affected items that require partner-level determinations (such as a partner's at risk amount that depends upon the source from which the partner obtained the funds that the partner contributed to the partnership) are subject to normal deficiency procedures. Temp. Treas. Reg. § 301.6231(a)(6)-1T(a).

We hope this memorandum is responsive to your concerns regarding at risk determinations under the TEFRA audit provisions.

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By:

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